

## California Public Employees' Retirement System

<i>Credit Profile</i>		
ICR due 12/31/2055		
<i>Short Term Rating</i>	A-1+	New

### Rationale

Standard & Poor's Ratings Services assigned its 'A-1+' issuer credit rating to the California Public Employees' Retirement System (CalPERS). The ICR is based on the strong creditworthiness of the system and its sponsors, which include the state of California (A+/Stable), along with the system's very strong liquidity enabling it to readily meet any short-term funding obligations under its credit enhancement program (CEP), as required.

CalPERS is the largest pension fund in the nation, with nearly 1.5 million members and a market value of assets totaling more than \$212 billion as of June 30, 2006.

Liquid investments of the pension system include cash, cash equivalents, and short-term instruments (including U.S. Treasury securities) that may be used to meet any potential draws under the CEP. CalPERS estimates that it has, on average, a minimum of more than \$20 billion in liquid assets on hand, which is more than adequate to meet any requirements under its CEP, which has an initial maximum commitment of \$5 billion.

CalPERS was established under legislation that became effective in 1932 to provide retirement benefits for state employees, and was subsequently expanded. The system currently includes 15 funds. The principal fund in the system is the Public Employees' Retirement Fund (PERF), which includes more than 99% of the system's retirement program net assets. The PERF is an agent multi-employer defined-benefit pension plan providing retirement, death, and survivor benefits to state, school (classified employees), and public agency members. Contributing employers include the state of California and about 1,500 schools and agencies. CalPERS is a component unit of the state and a unit of the California State and Consumer Services Agency, but is not subject to administrative direction by any department, commission, board, bureau, or agency of the state. Under the state constitution, the

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retirement board (CalPERS Board of Admin.) has sole and absolute authority and fiduciary responsibility for the investment of monies and administration of the system. CalPERS maintains comprehensive management policies in areas such as investment and risk management, and is a global leader in governance issues.

The PERF's funded ratio—the actuarial value of assets divided by the actuarial accrued liability—has historically been higher than the national average for public pension funds. As of June 30, 2005, the PERF's funded ratio was 87.3%. The PERF has a long history of receiving at least 100% of the annual required contribution from employers.

The CalPERS credit enhancement program has an initial maximum commitment of \$5 billion, or about 2.4% of the market value of PERF assets as of June 30, 2006. The primary objective of the program is to earn incremental fee income in support of municipal infrastructure development throughout the U.S. with a zero-loss underwriting standard. The program provides both credit and liquidity enhancements. As of June 30, 2006, the CEP had roughly \$562 million in contingent liabilities, with about \$1.4 million of fee income.

## Pension Fund And Sponsors

CalPERS was created by a voter-approved constitutional amendment authorizing legislation, which became effective in 1932, to establish a pension system for state employees. The system has expanded, and currently administers 15 funds including five defined-benefit retirement plans—the largest of which is the PERF, with net assets comprising more than 99% of system net assets. CalPERS also administers four defined-contribution retirement plans, two health care plans, and four other funds.

The CalPERS Board of Administration is responsible for the management and control of the system. The board consists of 13 members: six elected by members, three appointed members, and four ex-officio members, including the state treasurer and state controller. Under the state constitution, the board has sole and absolute authority and fiduciary responsibility for investment of monies and administration of the retirement system. System assets are held for the exclusive purposes of providing benefits and paying the expenses of the system. Board members are required to discharge their duties with respect to CalPERS in a prudent manner, and the board's duty to participants and beneficiaries takes precedence over any other duty.

The PERF is an agent multi-employer defined-benefit plan that receives contributions from employees and employers, including the state and about 1,500 other employers. As of June 30, 2006, the PERF had about 1.5 million members and benefit recipients, including about one million active and inactive members. Membership of PERF falls into four major categories: safety, including the state highway patrol; schools, including nonteaching employees; state industrial, including the department of corrections; and general or miscellaneous members. Members become fully vested after five years of credited service (10 years for second-tier members).

The state of California makes up approximately 31% of CalPERS' members. School employees comprise about 37% of the system's membership. The remaining 32% of membership comes from cities, counties, districts, and other public agencies in the state. Agencies may enter into new contracts with CalPERS for retirement, death, and survivor benefits, and may also terminate their contracts.

## Resources

The PERF is the principal pension trust fund in CalPERS, with net assets held in trust for pension benefits totaling \$212 billion as of June 30, 2006, representing more than 99% of system assets. The PERF has received an average of about \$17.5 billion a year in revenues over the past 10 years. These revenues flow from contributions from members (employees) and employers and investment income. Employee membership is broken down as follows: state employees (31%), school employees (37%), and local public agency employees (32%). Employee

contributions, which have averaged 11.6% of total revenues for the past 10 years, are at rates defined by law. Such employee contribution rates are based on the individual employer's formulas and can amount to up to 9% of compensation. Employer contributions represent 14.5% of total revenues, on average, and rates are set based on actuarial valuations or by state statute.

Investment income has accounted for 73.7% of total PERF revenues over the past decade. Asset allocation targets include 66% equities (40% domestic, 20% international, and 6% alternative investments/private equity); 26% global fixed income; and 8% real estate. The average annual return for the 10 years ended June 30, 2006, was 9.0%, including 11.8% for fiscal 2006. A change in the PERF net investment return assumption to 7.75% from 8.25% was approved by the board in April 2004. The state constitution gives the boards of the retirement systems sole and exclusive fiduciary responsibility over the assets of the system.

## Obligations

The primary objective of the PERF is to pay retirement, disability, death, and survivor benefits. In the PERF, benefit provisions for state and school employees are established by statute, and benefits for public agencies are established by contract with the system. These defined benefits are based on members' years of service, age, final compensation, and respective benefit formula. In fiscal 2006, the PERF paid about \$9.2 billion in retirement benefits.

## Funding Levels

CalPERS has a long history of very strong funding levels that have been above average for public funds in the U.S. As of June 30, 2005, the PERF's funded ratio—the actuarial value of assets divided by the actuarial accrued liability—was 87.3%.

### *CalPERS Funding Progress: Public Employees Retirement Fund*

*As Fiscal Year-End June 30*

<i>(Bil \$)</i>	<i>Actuarial value of assets</i>	<i>Actuarial accrued liability</i>	<i>Unfunded actuarial accrued liability</i>	<i>Funded ratio (%)*</i>
2005	183.7	210.3	26.6	87.3
2004	169.9	194.6	24.7	87.3
2003	158.6	180.9	22.3	87.7
2002	156.1	164.0	7.9	95.2
2001	166.9	149.2	(17.7)	111.9
2000	162.4	136.0	(26.5)	119.5
1999	148.6	115.7	(32.9)	128.4
1998	128.8	106.9	(21.9)	120.5
1997	108.6	97.9	(10.6)	110.9
1996	94.2	96.8	2.6	97.3

\*Actuarial value of assets divided by actuarial accrued liability.

## Credit Enhancement Program

The primary objective of the CalPERS CEP is to earn fee income. The CEP supports municipal infrastructure development throughout the nation by providing credit (such as an LOC) or liquidity (such as SBPA agreements) enhancements. The program operates under a zero-loss underwriting standard.

The CEP has a limit of \$5 billion, or 2.4% of the market value of PERF assets, as of June 30, 2006. The guidelines for issuers eligible for a CalPERS enhancement include the requirement that they be rated investment grade by two nationally recognized rating agencies. The average credit quality of the program's portfolio will be the long-term rating of 'A'. The weighted average maturity will not exceed five years. Guidelines also include geographic distribution, including a goal to align the program's portfolio with states having the largest populations. In addition, sector and single-risk limit guidelines add to diversification. A prudence certificate is prepared on each transaction. As of June 30, 2006, the CEP had about \$562 million in contingent liabilities and approximately \$1.4 million in fee income.

CalPERS has ample liquidity to handle any draws related to the CEP. Liquid investments of the pension system include cash, cash equivalents, and short-term instruments, including U.S. Treasury securities. CalPERS estimates that it has, on average, a minimum of more than \$20 billion in liquid assets on hand. Adding to the liquidity of the system's investment portfolio are annual ongoing revenues from employee and employer contributions (\$9.5 billion in fiscal 2006) and investment income (\$5.4 billion), including interest and dividends but excluding appreciation.

#### ***Ratings Detail (As Of 24-Jan-2007)***

California Pub Employees Retirement Sys ICR due 12/31/2055

***Short Term Rating***

A-1+

New Rating

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